COMGEST GROWTH JAPAN
WELL-POSITIONED FOR JAPAN'S ECONOMIC NORMALISATION AND BEYOND

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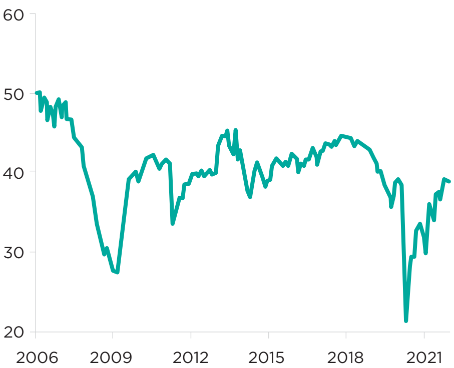
- As Japan lifts Covid restrictions later than in the West, we believe investors can look forward to a strong recovery in 2022.
- We consider the Comgest Growth Japan Fund (the "Fund") is well-positioned to benefit from the reopening of Japan's economy.
- As the economy normalises, several holdings should see their profitability boosted in the near-term and beyond, in our view.
- We consider the Fund to be attractively valued at a multi-year P/E low relative to the TOPIX Net Return Index.

Figure 1. Consumer Confidence in Japan is recovering



Source: Cabinet Office of Japan. Consumer Confidence Japan, with 2006 as 50.[4]

As Covid-19 restrictions lift, people are flocking back to the real economy to savour their favourite activities: shopping, eating out and travelling. International tourists are banned for now and some Covid-19 measures remain, but the direction of travel is towards economic normalisation.[1] Our quality retail growth companies are increasing offline sales (year-on-year, 4Q21), eating out is resuming and domestic flight traffic has recovered to 82% of pre-Covid-19 levels.[2] Although restrictions are being lifted later than in the West, they are likely to be completely removed in the near-term.[3]

The Fund is invested in several holdings which are beneficiaries of economic normalisation. We believe these businesses' profitability should be boosted by a revival in consumer spending and international tourism. For sure, additional waves of infection may occur, along with other unpredictable events, but consumer confidence has largely bounced back *(see figure 1)*. This should, in our view, support these businesses' recovery in the near-term and beyond.

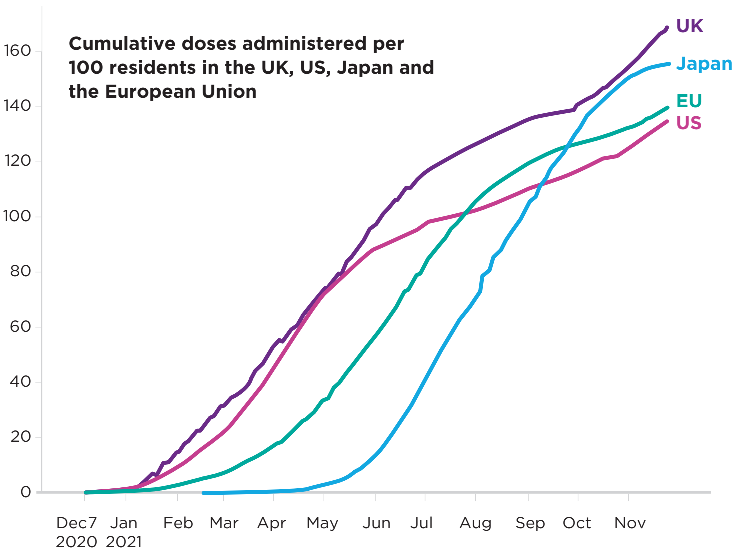
Turning to performance, the Fund suffered last year and into this year from Omicron fears and a style rotation away from quality growth stocks. However, we expect this rotation to be short-lived. This year we have also seen the Russia-Ukraine war triggering a global sell-off in equities. Oil and other commodity prices are rising, fuelling fears of a stagflation shock to the global economy.

[1] Sources: Reuters, 'Japan's economy likely rebounded in Q4 on solid consumption', as of 4 February 2022. Trading Economics, Japan GDP Growth Annualised – 2021, February 2022.
[2] A 'quality-growth' company is one that delivers superior, long-term earnings growth with below-average risk. Sources: offline sales - Pan Pacific International Holdings, Company website, February 2022; Eating out - Food & Life Companies, Press Release, 'Consolidated Financial Results for the 1st Quarter Ended December 31, 2021'; and Domestic flight traffic - Japan Airport Terminal, as of October 2021.
[3] Source: Inside Japan, 'Latest Coronavirus News from Japan', as of 22 February 2022.
[4] Source: The result of the survey of Economic and Social Research Research Institute of the Cabinet Office, as of January 2022.

In our view, the companies within Comgest Growth Japan will not suffer notably as input costs increase. Japan's Consumer Price Index remains well below 2%, a lower level than that found in western economies.[5] With an ageing population, fewer people are buying houses and cars every year, and this acts as a counterweight to rising input costs. Our research supports the team's view that Japan's automobile and semiconductor companies can source component parts from regions other than Russia, or the Ukraine.[6] Furthermore, from an end-market perspective, the most exposed company in the Fund is Suzuki which only sells approximately 1% of its global car volume in Russia.[7]

Despite recent weak performance, Comgest Growth Japan has returned 11.6% per annum since inception, outstripping the 7.7% annualised return achieved by the TOPIX Net Return Index.[8] Currently, our Fund is trading at a multi-year PE low relative to this index.

Figure 2. Japan's vaccination rate is among the highest.



Source: Official data collated by Our World in Data. World Health Organization, Data as of 2 January 2022.[12]

JAPAN'S GRADUAL NORMALISATION

Japan's GDP recovered somewhat in 4Q21, growing by 1.3% (quarter-on-quarter).[9] The increase in Omicron cases earlier this year triggered 16 of Japan's 47 Japan's local governments to reinstate a "quasi-state of emergency".[10] However, these actions were reversed in March (2022), particularly as a large percent of the population is fully vaccinated *(see figure 2)*.[11]

Beneficial for the economic outlook, also, is a record-breaking $490 billion stimulus package. Unveiled by the Prime Minister, Fumio Kishida (November 2021), it provides cash and coupon handouts as well as pay raises for nurses and care workers. Within the Fund, the discount retail holding, Don Quijote (Pan Pacific International Holdings) and Kobe Bussan (an offline food supermarket chain) should be key beneficiaries of such measures, in our view.

Pent-up consumer demand is already finding an outlet in many reopened restaurants, shops and hotels. Recent evidence among our Fund's holdings is widespread. For example, Kobe Bussan reported 3.1% same store sales growth for January (2022),[13] while Orix's management highlighted to the team that its domestic hotel chains have recovered to reach a 75% utilisation level from zero at the start of Covid.

Turning to travel, optimism about the imminent return of international tourists is high. This should have a powerful ripple effect, boosting many sectors of the economy, in our view. Most tourist attractions were shut down for a second time as Omicron gained traction. Now, the good news is that most of them have just reopened.

In the Fund, we believe those holdings that suffered from a lack of footfall during Covid will benefit as consumer behaviour normalises. Furthermore, we regard these holdings as fundamentally attractive longer-term. Many have provided reassuring earnings and guidance figures recently, some of which are mentioned below. So far this year, the indicators are positive for the near and long term.

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[5] Source: Trading Economics, https://tradingeconomics.com/japan/core-inflation-rate, February 2022.
[6] Source: Suzuki's management highlighted to the team that components can be sourced outside of Russia and the Ukraine, for example rhodium can be obtained from South Africa. Since the 2014 Crimea crisis, the company has reduced its reliance on Russia.
[7] Source: Suzuki's company website, 'Financial Presentation 3Q21', 4 February 2022.
[8] Source: Comgest / FactSet financial data and analysis, unless otherwise stated. Data as of 28 February 2022 expressed in JPY. Inception date as of 1 July 2009, which refers to the date the current team took over management of the Fund. Index: TOPIX- Net Return.
[9] Source: Trading Economics, Japan GDP Growth Annualised – 2021, February 2022.
[10] Source: Metropolis, 'Coronavirus in Japan: Updates, Tips and Resources', March 2022.
[11] Source: Inside Japan, 'Latest Coronavirus News from Japan', 31 March 2022.
[12] Source: Morgan Stanley, 'Japan Economics: Japan's Economy from a High-frequency Data Perspective', 25 February 2022.
[13] Source: Company website, February 2022.

OFFLINE SHOPPERS ARE RETURNING WITH VIGOUR

Fast Retailing, the owner of the globally established Uniqlo clothing brand and a long-term fund holding is another large beneficiary of the reviving offline consumer. Although Uniqlo operates online, it invests heavily in its store design to encourage customers to visit them, the positive effect of which was lost during Covid. It is now being regained.

Our company view in the short and long term is partly supported by management's investment in the automation of the business's logistics centres. This investment included a nationwide distribution and inventory management hub, the Ariake Project, which also helps management to optimise pricing decisions. We anticipate that the lead time from online customer orders to shipping will fall substantially.

Source: Fast Retailing's corporate website, 02/2022.

Equally important, in our view, is Uniqlo's rapid expansion in Greater China. With a store design and location that appeals to the emerging Asian middle class, the Uniqlo brand's growth has outpaced European competing brands over the last five years.[14] These are some of the factors that leads us to expect this retailer to achieve double-digit profit growth and operating margins over the long term.

Source: Kosé's corporate website, 02/2022.

Other retail holdings include, **Kosé**, a multinational personal care company. Last quarter, Kosé's sales at the Hainan Island Duty Free Zone in China grew 40% (quarter-on-quarter).[15] In February (2022), this company guided for 9% and 41% sales and operating profit growth respectively for the coming fiscal year and reiterated its 15% medium-term operating profit margin target.[16] It is evident that Kosé's prestige brands are continuing to benefit from Japan's economic normalisation and their growing presence in China.

Similarly, **Pan Pacific International Holdings**, which operates the discount chain, Don Quijote, delivered 5.5% operating profit growth in its latest quarterly results (year-on-year). This was achieved despite concerns about the impact of Omicron on consumer demand. From our perspective, these results somewhat reflect the company's excellent execution in procurement which helped to mitigate input and freight cost inflation.

Over the longer term, we believe this business is well-positioned to boost its profitability. Management continues to improve the supply chain and store formats which should encourage customers to purchase a wide variety of foods, amusements, clothes and electrical appliances. Meanwhile, the company's acquisition of the Uny supermarkets should add further potential growth in the coming years, in our view.

Source: Pan Pacific International Holdings' corporate website, 02/2022.

EATING OUT IS MAKING A COMEBACK

Gastronomy should also experience a recovery this year. Among the restaurant companies, we believe Japan's largest sushi restaurant chain, **Sushiro (Food & Life Companies)** is particularly well-positioned to profit from an economic recovery. Last quarter, the restaurants located in Japan grew revenue by 3.4% (year-on-year), a pace which should only accelerate as eating out takes off again. Although the company's rival, Kura has introduced discounts, Sushiro has not only retained its loyal customer base but has grown its domestic market share.[17]

[14] Source: Martin Roll, Business & Brand Leadership, 'Uniqlo: The Strategy Behind The Global Japanese Fast Fashion Retail Brand', January 2021.
[15] Source: Channel checks at Hainan Island Duty Free Zone (China), January 2022.
[16] Source: Company website, 'Financial Results Briefing for the Fiscal Year Ended December 2021', 14 February 2022.
[17] Source: Company website, Consolidated Financial Results for the 1st Quarter Ended December 31, 2021, Medium-term Management Plan (FY2019/9-FY2021/9), February 2022.

Looking beyond the near-term recovery, Sushiro is a highly automated, quality, low-cost sushi franchise which has consistently gained market share by opening new restaurants in metropolitan areas and overseas. In our view, these stores are highly competitive, and deliver an attractive return within a short space of time. Our research into consumers' reactions to the franchise in Hong Kong and China have reinforced our impression of this business's success in opening new stores. In our opinion, the company's expansion program should support steady profitable growth going forward.

Source: Food & Life Companies' corporate website, 02/2022.

RETURNING TOURISTS AS TRAVEL BAN LIFT

Source: Japan Airport Terminal's corporate website, 02/2022.

As the operator of the third busiest airport in Asia (2020), Haneda International Airport (Tokyo),[18] **Japan Airport Terminal** should experience a sharp boost to activities as tourist numbers increase going forward. Although the borders for international tourists are yet to be opened, returning residents are waived quarantine, and foreign business individuals are being permitted to enter the country for the first time in two years. Recent news that the airport was authorised as of February 2022 to increase its landing charge per passenger from Y2650 to Y2950 is particularly welcome.[19] Hence, as international travel recommences, the revenue contribution should be even larger than the expected volume recovery would imply.

We have also noted that searches for 'Japan Travel' on Chinese search site Baidu.com more than doubled during February versus six months previously – nearly all those potential visitors could become customers of Japan Airport Terminal.

In the long term, we believe the company will be a key beneficiary of the government's intention to boost its tourist arrivals significantly by 2030. The government's target is 60 million tourists, an increase from under 10 million in 2018.[20] The significant rise in the expected number of tourists will help support Japan Airport Terminal's growth outlook.

Our holding in **Oriental Land**, the owner and operator of Disneyland Tokyo, is also linked to the return of tourism. With 50% of its business in Japan,[21] this company is well-placed, in our opinion, to achieve higher sales and profit growth (year-on-year). The company has expanded its capacity to absorb more guests, and already the guest numbers in December (2021) were 50% higher than the company had anticipated.[22] This has contributed to management's positive outlook, which is clearly evidenced by the lifting of the hiring freeze on cast members and part-time employees at the end of 2021.

Source: Oriental Land's corporate website,02/2022.

We now anticipate as high as a 70% recovery in visitor numbers versus the current level. This coupled with higher spending per visitor than before Covid at shops and facilities which have been denied to them for so long. Like Haneda Airport, we believe Tokyo Disneyland will enjoy a revenue recovery in excess of its volume recovery.

Finally, our holding in **Recruit Holdings**, the HR recruitment business, is also a beneficiary of the economy normalising. Although best known for its global Indeed.com and Glassdoor.com businesses, it also owns large marketing media portals in Japan, such as Jalan.net (a travel booking site) and Hot Pepper Gourmet (an online restaurant booking site).

[18] Source: Airports Council International, 2020 statistics.
[19] Source: CLSA, 'Japan Airport', 18 January 2022.
[20] Source: TTG, 'Japan sticks to 60 million tourists by 2030 target', 14 October 2021.
[21] Source: Company website, 31 December 2021.
[22] Source: Company management meeting, February 2022.

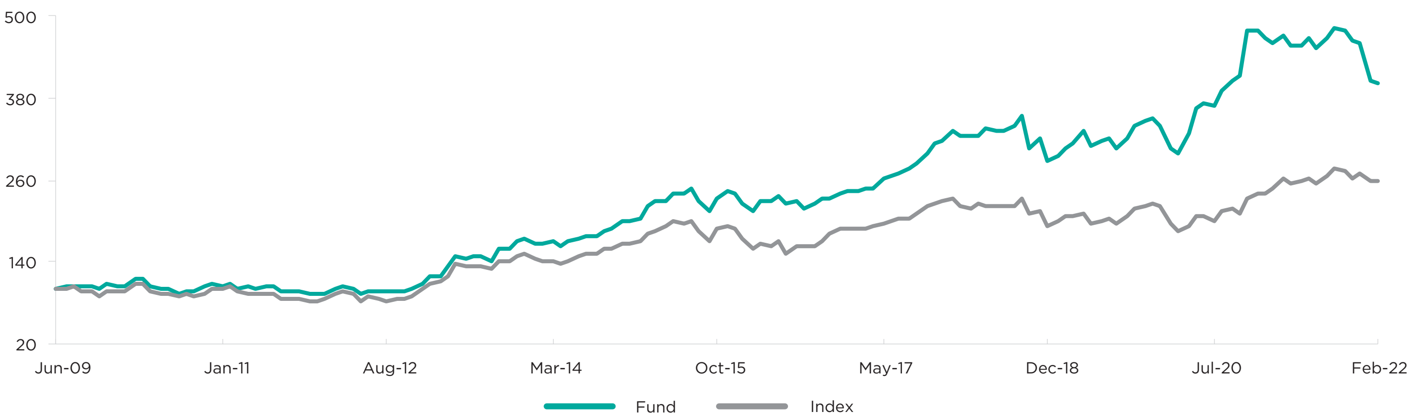
ROBUST OUTPERFORMANCE SINCE INCEPTION

Last year and into this year, the Fund suffered from a style rotation into inflation plays, such as financial and shipping stocks, as well as poor ESG performers including oil and gas producers. Such a rotation reduces our alpha, as we have a low exposure to these sectors. Also, large-cap stocks were favoured given uncertainty about Covid-19, and this acted as a further dampener as the Fund is well-diversified across the market cap spectrum.

Importantly, we expect this rotation to be short-lived. The expectation that inflation would help the banks to grow loan books and improve their interest rate spreads is misplaced, in our view, while we already anticipate that Japanese shipping stocks will begin to weaken given a recent decline in the Baltic Dry Index.[23]

Despite weak recent performance, Comgest Growth Japan has returned 11.6% per annum since inception, outstripping the 7.7% annualised return achieved by the TOPIX Net Return Index *(see figure 3)*.

Figure 3. Comgest Growth Japan Net Performance Under Current Team versus TOPIX Net Return Index (%)



Source: FactSet / Comgest data for Comgest Growth Japan JPY Acc: 01 July 2009 – 28 28th February 2022. Past performance is no guarantee of future results. Performance figures are calculated net of investment management fees, administrative fees and all other fees with the exception of sales charges. If taken into account, sales charges would have a negative impact on performance.

Figure 4. Calendar Year Performance & Annualised Returns Since Inception* (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Inception
Fund	**-1.7**	**-13.8**	**18.9**	**60.0**	**13.9**	**19.9**	**0.2**	**33.0**	**-9.8**	**21.8**	**37.0**	**-3.6**	**11.6**
Index	0.8	-17.1	20.7	54.2	9.9	11.7	0.0	21.8	-16.3	17.7	7.0	12.4	7.7
+/- Index	-2.5	3.3	-1.8	5.8	4.0	8.2	0.2	11.2	6.4	4.2	30.0	-15.9	3.9

*Source: Past performance is not a reliable guide to future performance. *Inception date: 1 July 2009. This date refers to the date the current team took over management of the Fund. Calendar year past performance is only shown for years for which a full calendar year of past performance is available. Performance data is expressed in JPY, as of 28 February 2022. Index: TOPIX Net Return Index. The index is used for comparative purposes only and the Fund does not seek to replicate the index. Performance figures are calculated net of investment management fees, administrative fees and all other fees with the exception of sales charges. If taken into account, sales charges would have a negative impact on performance.*

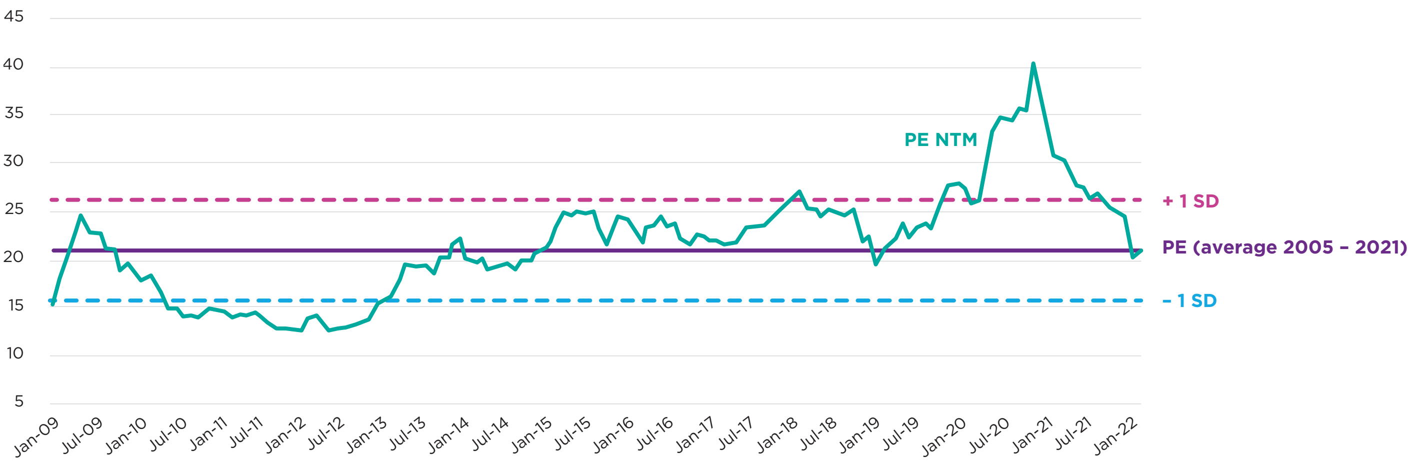
VALUATION OFFERS AN ATTRACTIVE OPPORTUNITY

We believe Comgest Growth Japan is now inexpensive on an absolute P/E *(see figure 5)* and relative P/E basis compared to the market. In fact, the Fund's valuation is at a multi-year P/E low (at 21x) relative to the TOPIX Net Return Index (14x) based on the period since the start of 2015 *(as seen in figure 5)*. Furthermore, the Fund is at the bottom half of its historical PEG ratio range at approximately 1.3x based on our 5-year EPS CAGR forecast of 16.7%.

[23] The Baltic Dry Index is reported daily by the Baltic Exchange in London. The index provides a benchmark for the price of moving the major raw materials by sea, taking into account 23 different shipping routes carrying coal, iron ore, grains and many other commodities.

To summarise, the Fund's quality growth companies in the retail and services sectors suffered from a lack of footfall during Covid. Most Covid-19 restrictions have now been lifted and, as such, we expect these companies to see a recovery in sales and profits. The most recent quarterly results season, and other evidence, is indicating they are already experiencing a rebound. Although the Russia-Ukraine war is a concern, our research suggests that companies within the Fund will not suffer notably from higher input costs and can source their component parts outside of the war zone. Also, they have limited exposure to Russia as an end-market. We believe 2022 is set to be a strong year for these businesses and continue to remain optimistic about their longer-term fundamentals. As such, we consider our high conviction concentrated Fund to be well-positioned now more so than ever.

Figure 5. Comgest Growth Japan – Historical Price-to-Earnings Ratio Range.



Source: Comgest / FactSet. Data as of 28 February 2022.

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Richard Kaye joined Comgest in 2009 and is a Tokyo-based Analyst and Portfolio Manager specialising in Japanese equities. He is also a member of the Comgest Group's Investment Committee. With a wealth of experience in Japanese equities, Richard became co-lead of Comgest's Japan equity strategy upon joining the Group. He started his career in 1994 as an Analyst with the Industrial Bank of Japan and then joined Merrill Lynch in the same role in 1996. In 2005 he moved to the Wellington Management Company in Boston as a Portfolio Manager of Japanese TMT stocks. Richard graduated from Oxford University where he majored in Oriental Studies.

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